

AR56

1997
Annual
Report



Spectrum Signal Processing

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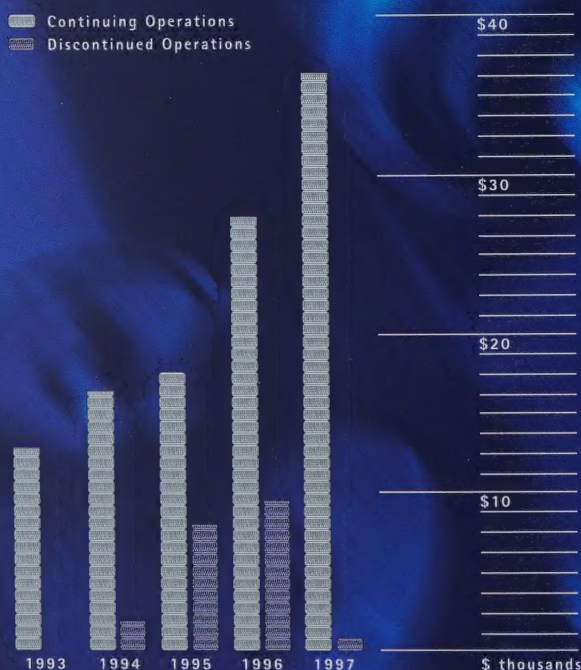
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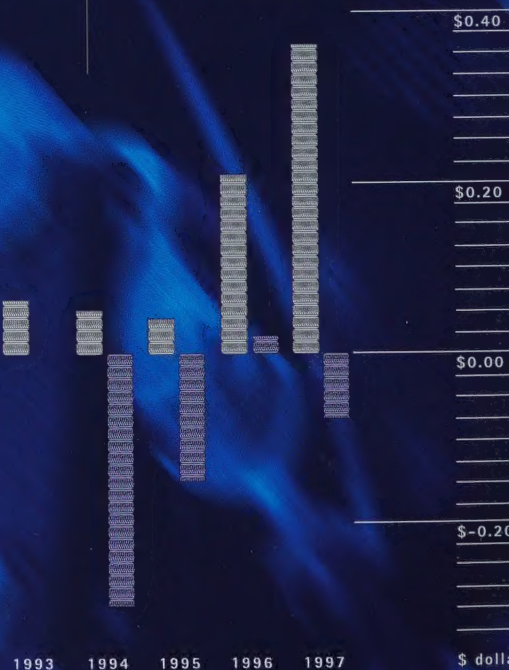
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high performance

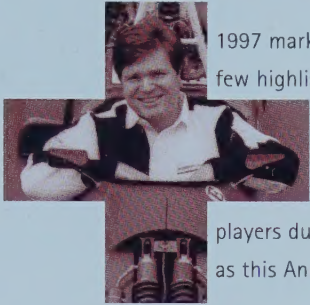
Continuing Operations
Discontinued Operations



Earnings per share from continuing operations



Letter to Shareholders



1997 marked Spectrum's 10th anniversary. Looking back across the decade, our growth has been strong. To mention just a few highlights, the staff has expanded from 10 to almost 200 while revenue has increased to \$37 million. From operating primarily as a distributor of technology licensed from third parties, Spectrum now manufactures over 80% of its product line in-house and, based on revenue, we achieved the position of the largest DSP systems company in the world. Also, while the DSP market has seen tremendous change and a decrease in the number of major players due to consolidation of the industry through acquisitions, we have emerged strong and strategically positioned – as this Annual Report shows.

Spectrum's current dominant position is definitely attributable to far-reaching initiatives completed during our 10th anniversary year. One of our primary goals was the elimination of dependence on third-party technology licenses. Despite our successful re-negotiation and extension of these agreements, we had already put the wheels in motion to develop our own products years prior to this. We moved to reduce dependence on a few large customers and to become the primary DSP systems supplier to rapidly expanding commercial, military and aerospace markets.

A healthy 36% growth in our DSP systems business last year has validated this business plan. In only one year, we launched over 20 Commercial-off-the-Shelf products, some of which are introduced on the following pages, and developed a new image backed by a naming strategy that references high-performance racetracks around the world. Revenue from these Spectrum-developed products grew 151% during the year.

Not only did we develop a broad selection of new products for original equipment manufacturer (OEM) customers, we also committed to being the first to market. For example, we unveiled a new product based on Texas Instruments' revolutionary C6X processor in September at the DSP World Fall Show in San Diego, substantially in advance of our competitors. This type of dedicated competitive initiative is one reason why in 1997 the BC Technology Industry Association named Spectrum 'Company of the Year', and the Canadian Advanced Technology Association presented the Company with their 'Emerging Technology Award.' I was also honoured as the Pacific Region 'Entrepreneur of the Year' for High Technology.

Last year, we recruited Texas Instruments' Worldwide DSP Market Manager Ron Wages as Vice President of Marketing, and made our first acquisition – 3L Limited, a Scotland-based DSP software company that specializes in multi-processor DSP Real-Time Operating Systems. In addition to providing us with a unique capability to provide a standard DSP-based Real-Time Operating System and an Integrated Development Environment to DSP customers, 3L will function as a foothold in the opportunity-rich European market. Affirming our decision to go global, returns on ventures in the European market were higher than projected.

To sum up, 1997 was good for business. Our move to discontinue the low-margin desktop computer telephony product line allowed us to focus all our attention on the continuing DSP systems business, which achieved after-tax earnings of \$3,307,000 or \$0.36 per share. This is an increase of 68% versus net earnings of \$1,974,000 or \$0.21 per share for the comparable period in 1996.

1997 was an exciting year for our dedicated, talented team, and we are geared up for the challenges of 1998. We thank you, our shareholders, for your continued support and will strive to provide substantial returns to you.

Yours sincerely,

Barry Jinks, President & CEO



Vision

Spectrum Signal Processing Inc. is a high-growth technology company which builds shareholder value through consistent profitable growth. Our goal is to maintain the leadership position in the DSP Systems Market worldwide in volume of product, revenue and overall growth.

Our Company is independent and creates valuable intellectual property through a combination of internal product development and strategic technology partnerships. Spectrum plans to reach its revenue goals by gaining the largest share of our chosen vertical markets. To this end, we have designed, manufactured and fielded the highest-performance DSP system solutions in the industry.



Spectrum's Executive Team is young, dynamic and very experienced in the high-tech sector.

Company Profile

Spectrum Signal Processing is the market leader in Digital Signal Processing [DSP] systems. Our Company provides many competitive advantages to original equipment manufacturers [OEM] customers by offering industry-standard products, leading-edge technology and fast time-to-market. Spectrum develops and manufactures products for every component of a DSP system, from signal processing software and operating systems to custom integrated circuits, plug-in boards and modules based on industry-standard computer platforms.

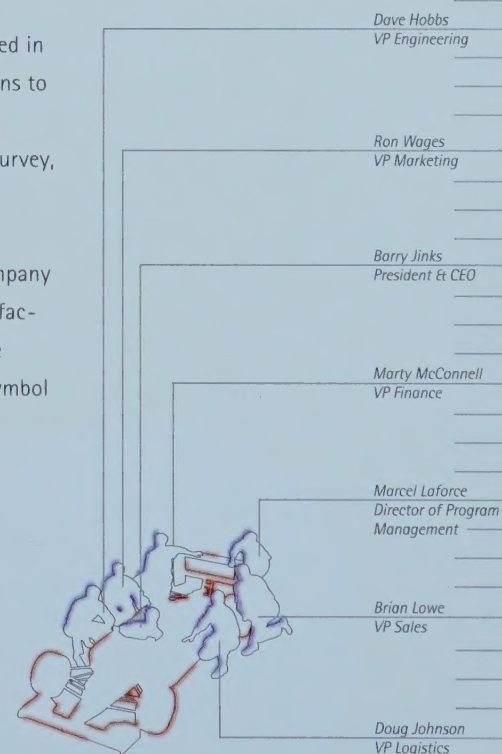
Our Company has an outstanding track record in the DSP industry for providing quality DSP systems coupled with superior customer support.

Spectrum's primary vertical markets encompass fast-growing market segments including wireless base stations, signal intelligence, radar/sonar and multi-channel modem. Our Company has an outstanding track record in the DSP industry for providing quality DSP solutions coupled with superior customer support, which has attracted long-term Fortune 1000 customers and partners including NEC, Boeing, Nortel, Hewlett-Packard, Siemens and Ford.

Spectrum's revenue has grown an average of 34% annually since 1991. Staff now numbers over 180, with almost half the Company directly involved in engineering and product development. Our seven-member Executive Team is young, dynamic and very experienced in the high-tech sector. Bringing a wide spectrum of personalities and business orientations to the management table, the Executive has emphasized the development of a strong and committed team by implementing such initiatives as an annual employee satisfaction survey, stock option program and an employee-run human resources committee.

Spectrum's corporate headquarters are located in Vancouver, British Columbia. The Company also supports field offices in the United States and the United Kingdom, and has manufacturer representative firms and distributors around the world. Spectrum is traded on the NASDAQ NMS under the symbol SSPIF and on the Toronto Stock Exchange under the symbol SSY. Spectrum can be found on the world wide web at: <http://www.SpectrumSignal.com>

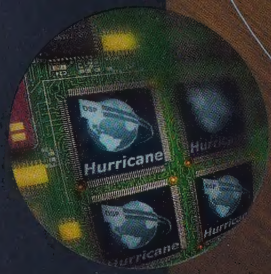
www.SpectrumSignal.com



wireless base stations

Spectrum Designs ASICs

The Barcelona board incorporates an Application Specific Integrated Circuit [ASIC] called Hurricane™ that was developed by Spectrum. The Hurricane™ bridge chip boosts our products to a higher level of performance than those of our competitors. At Spectrum we have more engineers than any other company in the DSP systems industry specifically dedicated to designing ASICs.

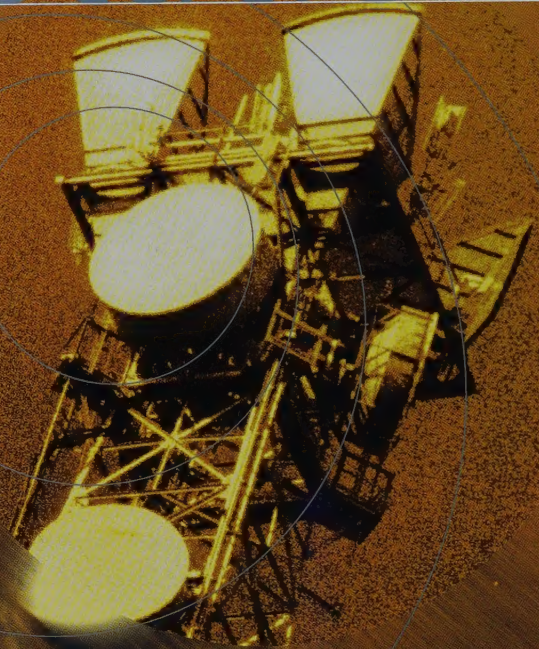


Barcelona Product

Typical Applications

- Wireless mobile switching center
- Wireless intelligent network
- Smart antennas
- Wireless TDMA, CDMA & GSM base station transceivers
- Third generation wireless base stations

Part #600-00077
Quad Product
1600 MIPS, 200MHz,
Quad C6201-based,
FastTrack architecture
eliminating double
handling of data, 2MB
or SDRAM and 64MB of
SDRAM. Hurricane is a
single chip PCI to DSP
bridge optimized for
DSP systems, with a
distributed shared
memory architecture.



What is DSP?

Digital Signal Processing is analogous to the human process of communication. Analog signals – such as light, sound and data – enter the computer/digital realm [the brain]. They are calculated in the realm of binary code's ones and zeros [the imagination] and are then sent back into the real world as processed signals [speech or action].

Just as an incalculable number of ideas, images and facts are processed by the brain in a moment, in just one second, a DSP chip can do millions of calculations on incoming analog signals. For example, stereo equipment handles sound signals of up to 20 kilohertz (thousands of cycles per second), requiring a DSP to perform hundreds of millions of operations per second. Other signals, such as satellite transmissions, are even faster, reaching up into the gigahertz (billions of cycles per second) range.

On a practical level, DSP is a portion of the digital technology market that is expected to grow two or three times faster than the booming computer industry as a whole. The technology is hot because digital signal processors and mixed-signal/analog allow us to apply the speed and precision of digital analysis and calculation to real-world situations.

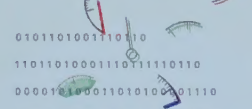
Robotics, process control, diagnostic imaging equipment, machine vision, wireless communications, base and ground stations, telecommunications, radar, sonar, factory automation, satellite imaging, avionics and fax/data modems all employ DSP. These industries require its speed, greater storage and communication capacity, ability to process and manipulate data in real-time, and ease of development and upgrade for multifunctional products using programmable hardware and software – thus shortening time-to-market for new products.

Simply put, DSP is the application of digital technology to real-world signals. Competition in the DSP market is expressed in the pressure to develop the best, fastest and highest-performance application or applications and bring the end product to market first.

How DSP Works



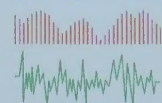
Analog



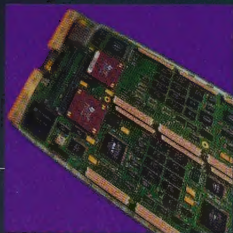
Digital



Analog



Part #600-04017
840 MFLOPS VXibus
DSP carrier board,
two embedded 60MHz
C4x DSPs with support
for 6 TIM-40 sites,
4 to 64MB of DRAM.



LeMans Product

Typical Applications

- Digital beam-forming
- Radio surveillance
- Software radio
- Spectrum monitoring

Spectrum Designs DSP Systems

Spectrum provides complete system solutions. For example, our Digital Radio solutions combine generic multipurpose boards and application-specific digital radio modules that we mount on carrier boards and then program with Spectrum-developed SoftRadio libraries and a real-time operating system. This results in a complete solution often with hundreds of DSP processors linked together in a DSP-based Radio System.

signal intelligence



How We Use DSP

Spectrum Signal Processing claims a unique position in the DSP market. We don't simply supply computer boards to our customers. Instead, Spectrum specializes in the design and manufacture of comprehensive market-specific systems based on programmable, high-performance DSP processors that perform different signal processing tasks based on the resident software.

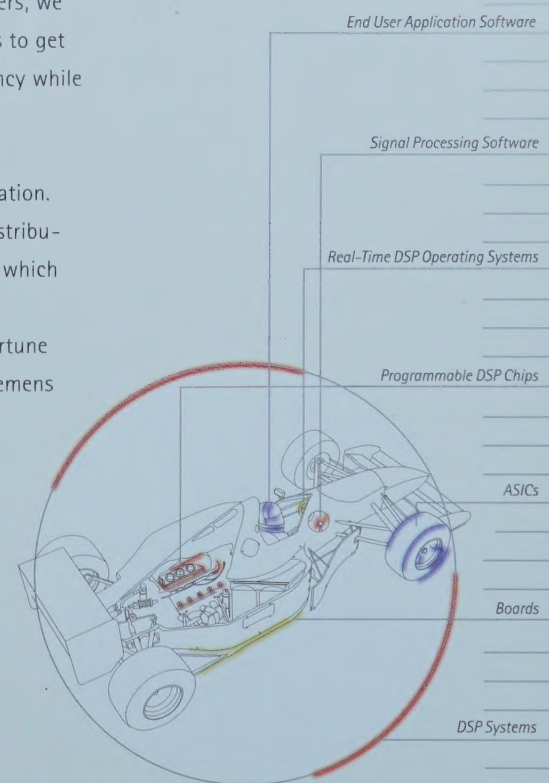
Most DSP systems consist of the following elements in addition to the DSP processor: application software which interfaces with the user's other electronic systems; DSP algorithms or specialized signal processing software that make the DSP processor function; DSP Operating Systems (much like Windows '95) that make the DSP algorithms work together in real-time; Application Specific Integrated Circuits (ASICs) or custom chips frequently used in the design of DSP hardware; DSP-based circuit boards which contain the DSPs, ASICs and other chips; and complete DSP systems consisting of several boards, modules, housing, cabling and other hardware.

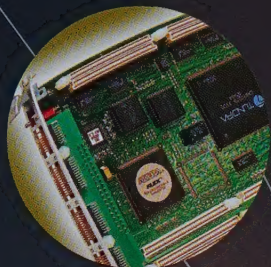
At Spectrum, we differentiate ourselves from the competition by offering expertise in all areas of DSP systems design, development and manufacture.

By applying our expertise to the needs of specialized and niche product manufacturers, we can provide Commercial-off-the-Shelf (COTS) DSP systems that assist our customers to get their products to market first and allow them to concentrate on their core competency while significantly reducing their in-house research and development costs.

Spectrum emphasizes quality and in doing so has achieved ISO-9001 quality certification. The scope of ISO registration covers the design and development, manufacturing, distribution and servicing of hardware, software and application specific integrated circuits which enables us to respond to and support our customer's product quality requirements. Throughout our history, Spectrum has developed and nurtured relationships with Fortune 1000 companies and industry giants such as Texas Instruments, Hewlett-Packard, Siemens and Northrop Grumman, as well as the US Department of Defense.

Spectrum's DSP System Model





Part #600-00037
Octal config. using 4
twin DSP modules 60MHz
C44s, up to 480 MFLOPS
VME64 master/slave DSP
board. Up to 8MB shared
memory architecture.
10 communication ports,
DSP~LINK3 interface for
I/O, four TIM-40 sites
offer wide range of
memory configs and
I/O options.

Maranello Product

Typical applications

- Electronic countermeasures
- Ocean floor surveying
- Weather radar
- Air surveillance radar
- Shipboard & submarine sonar



Spectrum Designs DSP Boards

Maranello - a full-
featured DSP systems
board - is one of
Spectrum's basic product
offerings. We began
selling boards more than
ten years ago and they
still comprise over
70% of our product line.
Now, however, they
are usually sold to
customers as simply one
component in a total
DSP system.

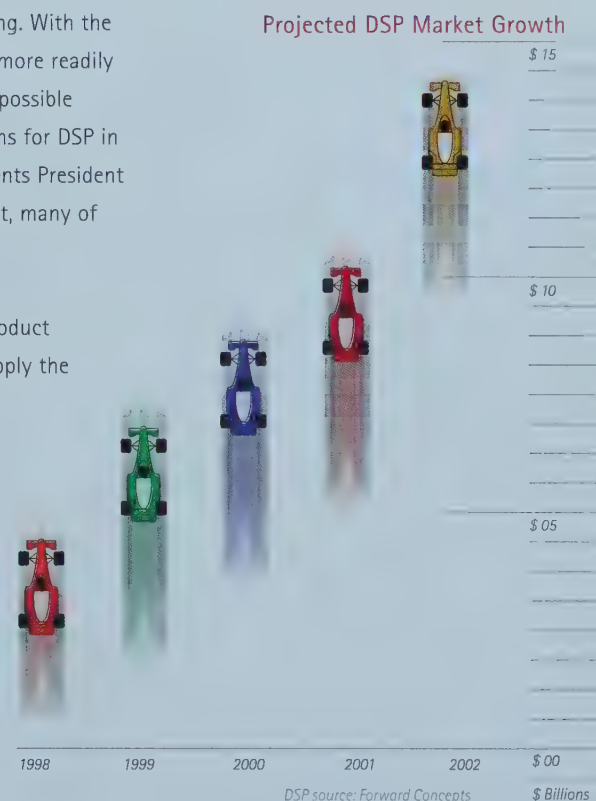
New Markets

Since 1987, the global market for DSP has grown at a compounded rate of more than 30% per year, which is faster than the growth rate experienced by the now universally employed microprocessor when it first came on the market.

Due to the initial cost of DSP, government, military and aerospace markets comprised most of the early adopters; however, as DSP chips come down the cost curve, large manufacturers are adopting the technology for commercial applications at a frenzied pace.

As well, recent trends, such as the next generation revolution in telecommunications, are driving increasing demand for greater speed and adaptability of signal processing. With the explosion of the digital cellular telephone market, DSP technology is becoming more readily available to the consumer market, which (based on the phenomenal number of possible applications) is a vast, untapped, DSP-hungry market sector. Possible applications for DSP in the evolving consumer products market are innumerable and, as Texas Instruments President & CEO Tom Engibous recently said, "it's safe to say that if you look ten years out, many of the common DSP applications haven't even been invented today."

As a supplier of DSP systems to various large-scale high-volume commercial product manufacturers, we have made strategic business decisions that enable us to supply the current market and position ourselves for the future.





Part #SPM-2200A
Four 1600MIPS, 280MHz
C6201-based DSPs, 2MB
of SBRAM and 64MB of
SDRAM, incorporates
Spectrum's Full-Cant
ASIC - a single chip
PCI bridge optimized for
DSP systems. Flexible
I/O interfaces, including
FEM modules providing
100Mbps per DSP
at 110 bauds.

Major Product

Typical applications:

- Internet Service
Providers (ISP)
- Remote Access
Servers (RAS)
- Communications servers
- Embedded Modems

Leading a competitive
industry, Spectrum develops
signal processing software
for DSP systems. For exam-
ple, we create specialized
algorithms for fax/modem/
data applications and
software libraries to enable
digital radio applications.

**Spectrum Develops
DSP Software**

multi-channel modem

Long-term Strategy

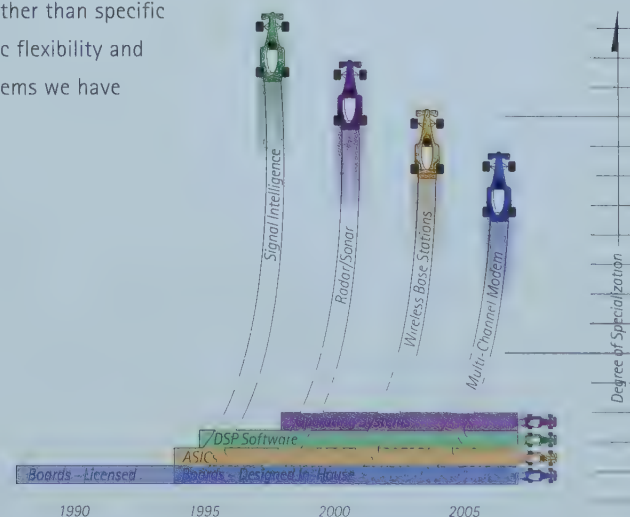
With an eye to opportunity in the burgeoning DSP market, Spectrum has established two priorities for 1998: Go Global and Target Vertical Markets.

As 50% of the market for DSP systems exists outside of North America, in mid-1997 Spectrum turned Company resources to tapping the European and Asia Pacific markets. With our acquisition of Scotland-based DSP software developer 3L Limited, Spectrum established a presence in Europe, and in the first quarter of 1998 we opened an office in London to service the European market. Currently, half of our distributors are based outside of North America. Last year, revenue from Europe was significantly above projections, while our focused Asian business met our revenue targets.

Focusing on developing vertical markets and employing a similar game plan as DSP provider Texas Instruments, Spectrum will target four major vertical markets aligned with our knowledge and expertise. They are wireless base stations, signal intelligence, radar/sonar and multi-channel modems. Our customers in these sectors will benefit significantly from the attention of a large DSP systems company that is geared to bringing the newest and most appropriate DSP technologies to market-specific applications. Our goal is to assist customers to be the first to market products, which ensures prominence in, if not dominance of, a market.

Last year's 36% increase in Spectrum's DSP systems business and 151% revenue growth for Spectrum-designed and manufactured products demonstrates that targeting energy and resources provide excellent returns. And, our new emphasis on markets rather than specific large clients results in greater independence, allows for increased strategic flexibility and enables us to retain the rights to the intellectual property of the DSP systems we have developed through strategic partnerships.

Areas of Specialization



3L Limited

In 1997, Spectrum purchased Scotland-based 3L Limited because of their valuable DSP software expertise in the Real-Time Operating System [RTOS] area. We invested in this layer of the DSP system to support our strategy of supplying complete DSP systems - we now own a large piece of that layer of the COTS/RTOS market.

Applications

- Automatic Vehicle Guidance
- Face-sensitive Automatic Camera Pointing
- Parallel Motion Picture Restoration System
- Real-time LIDAR



Spectrum subsidiary 3L Limited specializes in the development of DSP-based RTOSs, 3L provides tools so a DSP software programmer can write their application in a software environment much like "Windows" provides for desktop PC users.

Spectrum
Systems and
Training Systems

Spectrum Office

Burnaby, British Columbia, Canada	Tokyo, Japan
North Vancouver, British Columbia, Canada	Osaka, Japan
Bellevue, Washington, USA	Atsugi, Japan
Milwaukie, Oregon, USA	Maebashi, Japan
Mountain View, California, USA	Seoul, Korea
Costa, California, USA	Edinburgh, Scotland
Barbours, California, USA	London, England
Chino Hills, California, USA	Rathgen, Germany
Carlsbad, California, USA	Burnside, Australia
Torrance, Arizona, USA	Sydney, Australia
Aurora, Colorado, USA	Adelaide, Australia
Minnetonka, Minnesota, USA	Singapore, Singapore
Tulsa, Oklahoma, USA	Ra'ananna, Israel
Hoffman Estates, Illinois, USA	
Plano, Texas, USA	
St. Louis, Missouri, USA	
Austin, Texas, USA	
San Antonio, Texas, USA	
W. Bloomfield, Michigan, USA	
Mississauga, Ontario, Canada	
Montreal, Quebec, Canada	
Aurora, Ohio, USA	
Houston, Texas, USA	
Dayton, Ohio, USA	
Huntsville, Alabama, USA	
Norcross, Georgia, USA	
Turnersville, New Jersey, USA	
Charlotte, North Carolina, USA	
Raleigh, North Carolina, USA	
Altamonte Springs, Florida, USA	
Clearwater, Florida, USA	
Boca Raton, Florida, USA	

go global

Management's Discussion & Analysis

Overview

The Company was founded in 1987 to manufacture and market products for the military/aerospace and commercial market in North America using digital signal processing [DSP] technologies licensed from Loughborough Sound Images Ltd. In 1993, the Company introduced its first Computer Telephony Integration (CTI) products for sale to original equipment manufacturers [OEM] and to consumers directly through retail distribution channels. In 1994, the Company developed a new release of its CTI product for high-volume production targeted to leading OEM customers such as IBM and OMRON. In 1994, the Company recorded a charge against inventory relating to its first generation retail CTI product, and in 1995 the Company terminated its retail distribution efforts due to high marketing costs and a failure to achieve significant market penetration, which resulted in operating losses. In 1997, the Company initiated plans to discontinue the operations of its desktop CTI business due to low gross margins prevalent in this market segment. The Company expects to close operations in this business in 1998. Sales of desktop CTI products accounted for 31.2% of sales in 1995, 32.2% of sales in 1996 and 1.9% in 1997.

The Company devotes significant resources toward product development and related research and development activities. In recent years, the Company has sought to enter into agreements with its OEM customers and others under which the Company receives fees in connection with the development of products in anticipation of production ("development contract fees"), and uses these fees to fund such product development. The Company first derived revenues from development contract fees in 1994. Development contract fees are recognized as revenue upon the achievement of predetermined development milestones, which also typically coincide with invoicing and payments. See Note 1 of the Notes to Financial Statements. Costs associated with development contract fees are generally included in research and development expenses.

The timing and amount of development contract fees and the relative mix between products sold to the military/aerospace and commercial markets has affected and will continue to affect period-to-period comparisons of gross profit and income from operations.

Results of Operations

Sales from continuing operations in 1997 were \$36,452,000, an increase of \$9,094,000 or 33.2% over sales in 1996. Included in 1997 sales were development contract fees of \$2,210,000, or 6.1% of sales, compared to development contract fees in 1996 of \$2,642,000, or 9.7% of sales. Development contract fees included fees generated in 1997 and 1996 by the development of Application Specific Integrated Circuits [ASIC] for applications in the Company's new ASICs and software market segment.

Gross profit increased to \$20,904,000 for 1997 from \$15,985,000 for 1996, an increase of 30.8%. Gross margin [gross profit as a percentage of sales] decreased to 57.3% in 1997 from 58.4% in 1996. The decrease in gross margin was due primarily to the reduction in development contract fees in 1997 over 1996.

Administrative, sales and marketing ["AS&M"] expenses consist primarily of salaries, sales commissions and benefits related to the Company's sales, marketing and administrative personnel and independent sales representatives. AS&M expenses for 1997 were \$11,006,000, or 30.2% of sales, compared to \$9,449,000 in 1996, or 34.5% of sales. AS&M expenses as a percentage of sales were lower in 1997 compared to 1996 due to the increase in sales, with improved economies from the existing administrative, sales and marketing infrastructure.

Amortization consists of the depreciation of the Company's fixed assets and amortization of acquired technology. Amortization expenses in 1997 were \$944,000, an increase of \$266,000, or 39.2%, over 1996. The increase in depreciation and amortization was due primarily to increased investment in fixed assets and acquired technology.

Research and development expenses consist primarily of salaries, related personnel benefits, engineering service costs relating to development contract fees and direct overhead costs. Research and development expenses were \$3,528,000 in 1997, or 9.7% of sales, compared to \$2,905,000 in 1996, or 10.6% of sales. The expenses in 1997 consisted primarily of costs associated with development contract fees relating to ASICs and software and military/aerospace projects. Total research and development expenditures for continuing operations and those capitalized as software and related development costs were \$5,465,000 in 1997, or 15.0% of sales, compared to \$3,765,000 in 1996, or 13.8% of sales.

Management's Discussion & Analysis

Other income, consisting primarily of interest income on short-term deposits, was \$15,000 in 1997 compared to other income in 1996 of \$39,000.

Deferred income taxes for 1997 were \$2,138,000 or 39.3% of earnings before taxes and discontinued operations, compared to \$987,000 or 33.3% of earnings before taxes and discontinued operations for 1996.

The Company had earnings from continuing operations in 1997 of \$3,307,000 compared to earnings of \$1,974,000 in 1996. Earnings per share from continuing operations in 1997 were \$0.36 per share, compared to earnings from continuing operations of \$0.21 per share in 1996.

Discontinued Operations

Sales in the desktop CTI business in 1997 were \$719,000, a decrease of \$8,837,000 or 92.5% over sales in this business in 1996.

Gross profit from discontinued operations decreased to \$265,000 in 1997 from \$2,007,000 in 1996, a decrease of 86.8%

Operating expenses in 1997 totaled \$1,475,000, a decrease of \$269,000 or 15.4% over operating expenses in this business in 1996.

In 1997, the net loss from discontinued operations totaled \$737,000, or (\$0.08) per share compared to net earnings of \$176,000, or \$0.02 per share in 1996.

Liquidity and Capital Resources

The Company has historically met its operating and capital requirements from cash flow from operations and funds generated by sale of its equity securities.

The Company has a credit facility with the Bank of Montreal [the "Bank"], consisting of a \$5,000,000 operating line of credit [the "Line of Credit"]. Borrowings under the Line of Credit bear interest at the Bank's prime rate plus 0.5%, unless the borrowings are denominated in US dollars, in which case the rate of interest is the Bank's US base rate plus 0.5%. Borrowings are due on demand and interest is to be paid monthly. Borrowings may not exceed certain percentages of a specified borrowing base consisting of domestic and

foreign accounts receivable. The Line of Credit agreement requires the Company to maintain certain financial ratios and limits capital expenditures to plan. Borrowings under the Line of Credit are secured by substantially all of the Company's current assets. As of the date of this report, the Company has outstanding borrowings under the Line of Credit of approximately \$370,000.

At December 31, 1996 and December 31, 1997, the Company's cash position was \$2,038,000 and \$1,979,000, respectively. Net cash provided by (used in) operations, financing and investments was \$116,000 and (\$59,000) in 1996 and 1997, respectively. For 1997, cash used in operations, financing and investments consisted primarily of cash from operations and proceeds from the issuance of common shares upon the exercise of options and for the acquisition of 3L Limited. This was offset by cash used primarily to increase inventories, fund discontinued operations, and for the purchase of fixed assets and software and related development costs. In 1996, cash provided by operations, financing and investments consisted principally of cash from continuing and discontinued operations and the receipt of funds upon the exercise of outstanding stock options. This was offset by cash used primarily to reduce accounts payable and for the purchase of fixed assets and software and related development costs.

Accounts receivable, net at December 31, 1996 and 1997 was \$11,493,000 and \$9,367,000, respectively. The Company's standard collection terms are net 30 days, subject to adjustment for certain customers.

The Company made capital expenditures of \$2,085,000 during the year ended December 31, 1996 and \$3,194,000 during the year ended December 31, 1997, primarily for computer equipment and software and related development costs. In 1997, the Company invested \$1,665,000 in the purchase of treasury shares and invested \$1,039,000 in the acquisition of 100% of the shares of 3L Limited, net of \$268,000 of cash acquired.

The Company believes that cash generated from operations and borrowings available under the Line of Credit agreement will be sufficient to meet its working capital and capital expenditure requirements in 1998. However, the Company may in the future require additional equity or debt financing to meet its working capital, fixed asset and acquisition

Management's Discussion & Analysis

requirements. There can be no assurance that additional financing will not be required sooner or, if required, that it will be available on a timely basis or on terms satisfactory to the Company.

Outlook

Management anticipates sales growth in 1998 in its continuing business of approximately 30%, based on the Company's current product offering, the successful release of new products stemming from its hardware, ASIC and DSP systems capabilities, and its investment in 1998 in new geographic and new vertical markets.

Risk Factors

Although the market for the Company's products appears to be expanding, its ability to remain competitive is dependent upon assessing changing markets and providing new products and capabilities. There can be no assurances that the Company will be able to develop or license new products to meet changes in the marketplace or that the sale of such new products will be profitable. Certain of the Company's competitors have greater financial resources than the Company and may be able to sustain recurring losses to establish a market share at the Company's expense.

The Company believes that inflation and other changes in prices have not had a material effect on the Company. The Company intends to continue to sell the majority of its products in US dollars while incurring costs in varying proportions in Canadian dollars, US dollars and other currencies. Thus, the Company's operations are susceptible to fluctuations in currency exchange rates. In addition, if the Canadian dollar rises relative to the US dollar, the Company's reported Canadian dollar sales and net income may be materially and adversely affected. While the Company does attempt to mitigate some of the risks of exchange rate fluctuations between the US dollar and Canadian dollar by denominating many of its payment obligations in US dollars and, to a lesser extent, through the use of exchange-traded or over-the-counter contracts, there can be no assurance that these strategies will substantially reduce the potential adverse effect of exchange rate fluctuations on the Company's business, financial condition or results of operations.

Information Concerning Forward-looking Statements

Statements in this MD&A, to the extent not based on historical events, constitute forward-looking statements.

Forward-looking statements include, without limitation, statements evaluating market and general economic conditions in the preceding sections, and statements regarding future-oriented costs and expenditures. Investors are cautioned not to place undue reliance on these forward-looking statements which reflect management's analysis only as of the date thereof. These forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially. Such risks and uncertainties with respect to the Company include the effect of general economic conditions, fluctuations in supply and demand for the Company's products, changing foreign exchange rates and actions by government authorities, uncertainties associated with legal proceedings and negotiations, industry production levels, competitive pricing pressures and misjudgments in the course of preparing forward-looking statements.

Year 2000 Issue

Spectrum has established a year 2000 program to coordinate and monitor the assessment, conversion or replacement, and testing of computer systems throughout the organization to ensure key business information and process control systems will function successfully after December 31, 1999. The Company is confident that all issues will be dealt with; however, a disruption of Spectrum's operations could occur, including a temporary inability to engage in normal business activities such as conducting general banking tasks, invoicing, material planning and purchasing. Spectrum has therefore committed internal resources to address the year 2000 issue. Progress for the continuing operations is centrally coordinated, with regular reporting of the status of our 2000 compliance to the Audit Committee and the Board of Directors. Costs related to hardware and software replacements and/or modifications will be capitalized and amortized at standard rates. Other costs will be expensed as they occur.

Spectrum has also initiated communications with suppliers to determine the extent to which Spectrum may be vulnerable to such parties' failure to remedy their own 2000 issues. There can be no guarantee that the systems of other companies on which Spectrum's systems rely will be converted in a timely basis. However, based on its current assessment, management believes the year 2000 issue will not have a material adverse effect on Spectrum's future results of operations or its financial conditions.

Auditors' Report to Shareholders

We have audited the consolidated balance sheets of Spectrum Signal Processing Inc. as at December 31, 1997 and 1996 and the consolidated statements of operations and retained earnings and changes in financial position for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1997 and 1996 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles. As required by the Company Act of British Columbia, we report that, in our opinion, these principles have been applied on a consistent basis.

KPMG

KPMG Chartered Accountants
Richmond, Canada, February 5, 1998

Consolidated Balance Sheets

Expressed in thousands
of Canadian dollars
as at December 31.

	1997	1996
Assets		
Current assets		
Cash and short-term deposits	\$ 1,979	\$ 2,038
Accounts receivable, net of allowance for doubtful accounts of \$243 (1996 - \$321)	9,367	11,493
Inventories	5,809	2,396
Prepaid expenses	315	707
	17,470	16,634
Capital assets (note 3)	3,501	2,920
Other assets (note 4)	3,762	1,124
	\$ 24,733	\$ 20,678
Liabilities & Shareholders' Equity		
Current liabilities		
Accounts payable and accrued liabilities	\$ 6,722	\$ 6,916
Current portion of long-term debt (note 5)	-	13
	6,722	6,929
Long-term debt (note 5)	107	-
Deferred income taxes	1,749	55
Shareholders' equity		
Share capital (note 6)	13,259	13,368
Contributed surplus (note 6)	106	106
Retained earnings	2,790	220
	16,155	13,694
Commitments (note 9)		
	\$ 24,733	\$ 20,678

See accompanying
notes to consolidated
financial statements.

Bf Samuel Znaimer

On behalf of the Board: Barry Jinks, President & CEO Samuel Znaimer, Director

Consolidated Statements of Operations & Retained Earnings

Expressed in thousands of Canadian dollars, except per share amounts.
Years ended December 31

	1997	1996
Sales	\$ 36,452	\$ 27,358
Cost of sales	15,548	11,373
	\$ 20,904	\$ 15,985
Expenses		
Administrative	4,372	4,158
Sales and marketing	6,634	5,291
Amortization	944	678
Research and development	3,528	2,905
	\$ 15,478	\$ 13,032
Earnings from Operations	5,426	2,953
Other revenue (expense)		
Interest and bank charges	4	(31)
Other income	15	39
	19	8
Earnings before income taxes and discontinued operations	5,445	2,961
Deferred income taxes (note 7)	2,138	987
Earnings from continuing operations	3,307	\$ 1,974
Earnings (loss) from discontinued operations (note 11)	(737)	176
Net earnings	2,570	2,150
Retained earnings (deficit), beginning of year	220	(1,930)
Retained Earnings end of year	\$ 2,790	\$ 220
Earnings per share (note 8)		
Basic		
From continuing operations	\$ 0.36	\$ 0.21
After discontinued operations	\$ 0.28	\$ 0.23
Fully diluted		
From continuing operations	\$ 0.34	\$ 0.21
After discontinued operations	\$ 0.27	\$ 0.23

See accompanying
notes to consolidated
financial statements.

Consolidated Statements of Changes in Financial Position

Expressed in thousands
of Canadian dollars.
Years ended December 31.



Cash Provided By (used in)	1997	1996
Operations		
Earnings from continuing operations	\$ 3,307	\$ 1,974
Items not involving cash		
Amortization	944	678
Deferred income taxes	2,138	987
Changes in non-cash operating working capital		
Accounts receivable	2,270	(4,818)
Inventories	(3,394)	754
Prepaid expenses	419	(322)
Accounts payable and accrued liabilities	(446)	2,491
Cash from continuing operations	\$ 5,238	\$ 1,744
Earnings (loss) from discontinued operations	(737)	176
Deferred income taxes, an item not involving cash	(473)	87
Cash from discontinued operations	(1,210)	263
	\$ 4,028	\$ 2,007
Financing		
Deferred share issue costs	263	(263)
Issue of shares, net of share issue expenses	1,556	496
Decrease in long-term debt	(8)	(39)
	\$ 1,811	\$ 194
Investments		
Purchase of treasury shares	(1,665)	-
Purchase of capital assets	(1,447)	(1,421)
Software and related development costs, net	(1,747)	(664)
Acquisition of the shares of 3L Limited net of cash acquired of \$268	(1,039)	-
	\$ (5,898)	\$ (2,085)
Increase (decrease) in cash and short-term deposits	(59)	116
Cash and short-term deposits, beginning of year	2,038	1,922
Cash and short-term deposits, end of year	\$ 1,979	\$ 2,038

See accompanying
notes to consolidated
financial statements.

Notes to Consolidated Financial Statements

Year Ended December 31, 1997

Amounts expressed in thousands of Canadian dollars,
except per share amounts and numbers of shares.

The Company was incorporated under the laws of British Columbia and its principal business activities include the design, manufacture and marketing of digital signal processing systems for incorporation into high-performance applications for original equipment manufacturers for commercial markets such as surveillance and wireless base stations, remote sensing, and multi-channel modems and for military and aerospace markets.

1. Significant accounting policies

The financial statements have been prepared in accordance with accounting principles generally accepted in Canada, which, in the case of the Company, generally conform with those established in the United States, except as explained in Note 13.

Basis of consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary 3L Limited.

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, particularly the recoverability of capital and other assets, and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from the estimates.

Cash and short-term deposits

Cash includes short-term deposits, which are all highly marketable securities with a maturity of three months or less. Short-term deposits are valued at cost.

Inventories

The Company uses the average cost method of accounting for its inventory. Inventories are valued at the lower of cost and net realizable value and consist of:

	1997	1996
Finished Goods	\$ 3,125	\$ 1,011
Raw Materials	2,684	1,385
	\$ 5,809	\$ 2,396

Research and development costs

Research costs are expensed as incurred. Development costs are expensed as incurred unless they meet certain criteria under generally accepted accounting principles for deferral and amortization. Software and related development costs, after the establishment of technological feasibility and commercial viability, are capitalized until the product is available for general release to customers. Amortization is provided on a product by product basis over the estimated economic life of the product, not to exceed three years. Amortization commences when the product is available for general release to customers. Research and development costs and capitalized software and related development costs can be summarized as follows:

	1997	1996
Research & development expense		
Continuing operations	\$ 3,528	\$ 2,905
Discontinued operations	423	872
Capitalized software and related development costs	1,937	860
	\$ 5,888	\$ 4,637

Capital assets

Capital assets are initially recorded at cost. Amortization is subsequently provided on the following assets using the declining balance basis at the following annual rates:

Computer equipment	30%
Computer software	20%
Furniture and fixtures	20%
Laboratory equipment	20%

Amortization of leasehold improvements is provided on a straight-line basis over the lesser of their estimated useful lives or five years.

License

The Company has the North American license to manufacture and distribute computer peripherals for digital signal processing systems designed by Loughborough Sound Images Ltd. The license was recorded at a nominal value of \$1 and expired in July 1997. During the year, the Company negotiated a non-exclusive extension of manufacturing rights to 2002 and distribution rights to January 17, 1999. Both the manufacturing and distribution rights may be extended under certain conditions.

Notes to Consolidated Financial Statements

Translation of foreign currencies

All monetary assets and liabilities denominated in foreign currency have been translated into Canadian dollars at the rate of exchange in effect at the balance sheet date. Other assets, revenue and expense items are translated at the rates prevailing at their respective transaction dates. Gains and losses resulting from foreign exchange translation are reflected in earnings for the year.

Acquired technology

The excess of the cost of acquisitions over the value assigned to identifiable net tangible assets acquired is allocated to acquired technology. The acquired technology is stated on the basis of cost less accumulated amortization of \$49 (1996 - nil), and is amortized on a straight-line basis over seven years with one half of the annual rate in the year of addition.

Revenue recognition

DSP products revenue is recognized upon shipment. Computer telephony integration ("CTI") product revenue, which is included in discontinued operations, is recognized upon the later of shipment or transfer of title. Revenue from product development contracts is recognized upon reaching certain development milestones which are generally correlated to the timing of payments.

Warranty

The Company generally provides a one-year warranty to the original purchaser. Warranty costs are accrued based on a best estimate, with reference to past experience.

Income taxes

The Company follows the allocation method for accounting for income taxes. Under this method, recognition is given in the financial statements to the tax effects of timing differences between income and expenditures for financial statement and income tax purposes.

The Company follows the cost reduction method of accounting for investment tax credits whereby the benefit of tax credits is recognized as a reduction in the cost of the related asset or expenditure when there is reasonable assurance the tax credits will be realized.

Share issue costs

The costs of issuing common shares, net of income tax recoveries thereon, are applied to reduce the stated value of such shares.

Deferred share issue costs

The majority of the costs incurred in the 1996 form F-1 registration and preliminary prospectus process were expensed in 1996. The process was abandoned in 1997 and therefore all the remaining deferred costs were expensed to operations.

Concentration of credit risk

Financial instruments that potentially subject the Company to concentrations of credit risk are primarily accounts receivable. Credit risk in receivables is limited to original equipment manufacturers and to dealers and distributors of hardware and software products. The Company performs ongoing credit evaluations of its customers' financial condition and requires letters of credit or other guarantees whenever deemed necessary.

Substantially all of the Company's revenues have been recognized in currencies other than the Canadian dollar, principally the United States dollar. Fluctuations in the exchange rates between these currencies and the Canadian dollar could have a material effect on the Company's business, financial condition and results of operations. The Company attempts to mitigate some of this risk by denominating many of its payment obligations in United States dollars, and, to a lesser extent, through the use of future exchange contracts.

Technological risks

The market for the Company's products is characterized by rapidly changing technologies, evolving industry standards and frequent new product introductions and enhancements. There can be no assurance that the Company will successfully develop, complete, introduce, and market new products or product enhancements, or that the products or product enhancements currently in development or that may be developed by the Company in the future will meet industry requirements and achieve market acceptance. Any significant delay or failure to develop, manufacture or ship new or enhanced products could have a material adverse effect on the Company's business, financial condition and results of operation.

Impairment of long-lived assets

The Company monitors the recoverability of long-lived assets, based on factors such as current market value, future asset utilization, business climate and future undiscounted cash flows expected to result from the use of the related assets. The Company's policy is to record an impairment loss in the period when it is determined that the carrying amount of the asset may not be recoverable.

Comparative figures

Certain comparative figures have been reclassified to conform with the presentation adopted in the current year.

Notes to Consolidated Financial Statements

2. Acquisition of 3L Limited

On June 20, 1997, the Company acquired all of the outstanding shares of 3L Limited. The acquisition has been accounted for using the purchase method of accounting and the results of operations have been consolidated since the date of acquisition. The Company's interest in the net assets acquired at assigned values are as follows:

Cash	\$ 268
Current assets	190
Capital assets	27
Acquired technology	1,204
Current liabilities	(382)
Acquisition cost	\$ 1,307
Consideration	
173,333 common shares	\$ 1,300
Expenses on acquisition	7
	\$ 1,307

The following unaudited pro-forma results of operations assume that the acquisition occurred as of the beginning of the respective periods presented:

Years ended December 31	1997	1996
Revenue	\$ 36,973	\$ 28,346
Earnings from continuing operations	3,283	2,029
Net earnings	\$ 2,546	\$ 2,205
Earnings per share		
From continuing operations	\$ 0.36	\$ 0.22
After discontinued operations	\$ 0.28	\$ 0.24

The unaudited pro-forma information given above does not purport to be indicative of the results that actually would have been obtained if the operations were combined during the periods presented, and is not intended to be a projection of future results or trends.

3. Capital assets

	1997	1996
Computer equipment	\$ 3,007	\$ 2,432
Computer software	1,346	1,020
Furniture and fixtures	1,077	837
Laboratory equipment	719	469
Leasehold improvements	424	349
	6,573	5,107
Less accumulated amortization	(3,072)	(2,187)
Net book value	\$ 3,501	\$ 2,920

4. Other assets

	1997	1996
Software and related development costs	\$ 2,607	\$ 860
Acquired technology, net of accumulated amortization of \$49	1,155	—
Deferred share issue costs	—	263
License	—	1
	\$ 3,762	\$ 1,124

5. Long-term debt

	1997	1996
Small Business Assistance program, repayable in monthly principal payments of \$3 plus interest at 6%	\$ —	\$ 13
Development loan	107	—
The company has received a loan from Lothian and Edinburgh Enterprise Limited ("LEEL") for the purpose of product development. There are no formal terms of repayment, and royalty payments are to be made to LEEL based on gross sales revenue of the particular product. If the company does not meet all the terms of the loan it becomes repayable on demand.		
	107	13
Less: current portion	—	(13)
	\$ 107	\$ 0

Notes to Consolidated Financial Statements

6. Share capital

(a) Authorized – The authorized capital of the Company consists of 50,000,000 common shares with no par value

(b) Issued and outstanding:



	Number of Shares	Stated Values
Outstanding, December 31, 1995	9,163,974	\$ 12,910
Issued for cash from share options	79,709	496
Outstanding, December 31, 1996	9,243,683	13,406
Issued for cash from share options	42,381	256
Issued for acquisition of 3L Limited	173,333	1,300
Outstanding, December 31, 1997	9,459,397	\$ 14,962
	1997	1996
Share Capital	\$ 14,962	\$ 13,406
less 233,300 shares held in treasury (1996 - 16,400)	(1,703)	(38)
	\$ 13,259	\$ 13,368

(c) Stock option plan – The Company has reserved 2,250,000 common shares for issuance under its stock option plan. The plan provides for the granting of stock options to directors, officers and eligible employees at the fair market value of the Company's stock at the grant date.

Options generally vest over three years in equal amounts at the anniversary date of the grant. Options generally have a five-year term with ten years being the maximum. Stock option activity for 1996 and 1997 is presented below:

	Number of Shares	Exercise Price per Share
Outstanding, December 31, 1995	1,216,646	\$ 0.70 – \$ 17.00
Granted	416,556	\$ 8.00 – \$ 16.10
Exercised	(79,709)	\$ 2.14 – \$ 9.00
Cancelled	(59,597)	\$ 4.80 – \$ 17.00
Outstanding, December 31, 1996	1,493,896	\$ 0.70 – \$ 17.00
Granted	330,353	\$ 7.00 – \$ 8.50
Exercised	(42,381)	\$ 1.86 – \$ 9.90
Cancelled	(124,580)	\$ 2.38 – \$ 17.00
Outstanding, December 31, 1997	1,657,288	\$ 0.70 – \$ 16.10
Exercisable at:		
December 31, 1996	731,898	
December 31, 1997	902,491	

The options outstanding at December 31, 1997 expire between August 6, 1998 and June 11, 2007.

d) Escrow shares – There are 42,985 shares, related to the 3L Limited acquisition, held in escrow at December 31, 1997 which

will be released on June 20, 2000.

(e) Contributed surplus – During 1994, the Company purchased and sold 248,000 of its common shares for proceeds in excess of cost of \$106.

Notes to Consolidated Financial Statements

7. Income taxes

Income tax expense varies from the amounts that would be computed by applying the Canadian federal and provincial income tax rate of 45.6% (1996 – 45.6%) to earnings before income taxes and discontinued operations as shown in the following table:

	1997	1996
Combined Canadian federal and provincial income taxes at expected rate	\$ 2,483	\$ 1,350
Permanent and other differences	7	5
Reduction of income taxes from use of unrecorded tax benefits	(352)	(368)
	\$ 2,138	\$ 987

As at December 31, 1997, the Company has earned investment tax credits of approximately \$300 and claimed an additional \$4,100 which are available to reduce future years' income taxes payable. These investment tax credits expire between 2000 and 2007. The potential tax benefits that may arise from the utilization of the \$4,100 have not been recognized in these financial statements.

The Company has losses for UK income tax purposes of approximately \$180 which can be carried forward indefinitely to reduce future taxable income.

8. Earnings per share

Basic earnings per share is calculated based upon the weighted average number of shares outstanding during the year, which was 9,234,926 (1996 – 9,194,558).

Fully diluted earnings per share reflect the dilutive effect of the conversion of the stock options outstanding at the end of the year or those options exercised during the year, as if they had been exercised at the beginning of the year or the date granted, if later. The number of shares used for the calculation of the fully diluted earnings per share is 10,146,238 (1996 – 9,527,772). Interest on the funds which would have been received had the options been exercised, in the amount of \$180 (1996 – \$24) net of income tax, has been imputed at a rate of 4% (1996 – 4%) per annum.

9. Commitments

The Company has entered into various operating lease agreements, with remaining terms of up to five years, for office premises and equipment. The minimum lease payments in each of the next five years are approximately as follows:

1998	\$ 774
1999	671
2000	665
2001	658
2002	259
	\$ 3,027

10. Segmented information

In the opinion of management, the Company operates in one industry segment, being the design, manufacture and marketing of digital signal processing systems. Substantially all assets and operations are in Canada. A summary of sales by region and by major customers is as follows:

By Region	1997	1996
United States	\$ 30,995	\$ 21,395
Canada and other	5,457	5,963
Total Sales	\$ 36,452	\$ 27,358
By Major Customer		
United States Government and related subcontractors	\$ 9,156	\$ 8,569
NAI Technologies	6,736	718
IBM, substantially all from discontinued operations	415	8,689

Notes to Consolidated Financial Statements

11. Discontinued operations

The Company initiated plans during 1997 to discontinue the operation of its desktop Computer Telephony board business ("CTI"). The CTI division is in the business of developing boards which integrate telephone, fax and modem functions into computers and selling them to OEMs and end users. The Company expects to close operations in this business in 1998. Accordingly, the results of operations and changes in financial position have been disclosed separately from those of continuing operations for the years presented. The financial position of these discontinued operations continues to be consolidated in accordance with generally accepted accounting principles.

The operating results of this business segment were as follows:

	1997	1996
Revenue	\$ 719	\$ 9,556
Gross margin	265	2,007
Expenses	1,475	1,744
Provision for taxes	(473)	87
Earnings (loss) from discontinued operations	\$ (737)	\$ 176

The net assets of discontinued operations are as follows:

Current assets	\$ 517	\$ 1,240
Current liabilities	-	(258)
	\$ 517	\$ 982

12. Financial instruments

- Fair value of financial instruments – Carrying amounts of certain of the Company's financial instruments, including accounts receivable and accounts payable and accrued liabilities approximate fair value due to their short maturities. Based on borrowing rates currently available to the Company for loans with similar terms, the carrying value of its long-term debt approximates fair value.
- Foreign exchange hedging – The Company utilizes future exchange contracts to manage its exposure to fluctuations in foreign exchange rates. These instruments are used for purposes other than trading and are employed in connection with an underlying asset, liability or anticipated transaction. At December 31, 1997, the Company had a futures exchange contract with a notional principal of \$1,500 (1996 – nil) Canadian dollars maturing on March 15, 1998.

13. United States accounting principles

The Company's financial statements presented herein have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). There are no material reconciling items between United States GAAP and Canadian GAAP that affect net earnings or total assets or liabilities and shareholders' equity except as follows:

Earnings	1997	1996
Earnings from continuing operations under Canadian GAAP	\$ 3,307	\$ 1,974
Acquired in-process research and development	28 (1,155)	-
Earnings from continuing operations under U.S. GAAP	\$ 2,152	\$ 1,974
Earnings (loss) from discontinued operations	(737)	176
Net earnings under U.S. GAAP	\$ 1,415	\$ 2,150

Earnings per share	1997	1996
Basic		
From continuing operations	0.23	0.21
After discontinued operations	0.15	0.23
Diluted		
From continuing operations	0.22	0.20
After discontinued operations	0.15	0.22

During 1997, the Company adopted Statement of Financial Accounting Standard No.128 ("FAS 128"), Earnings Per Share. Accordingly, historical earnings per share have been re-stated under FAS 128. Basic earnings per share is the same under Canadian and United States GAAP. Diluted earnings per share under United States GAAP is based on the weighted average number of common shares outstanding. When dilutive, stock options and warrants are included as share equivalents using the Treasury Stock method.

Re-stated

Same as C.D.N. D.O.

Notes to Consolidated Financial Statements

The following weighted average number of shares were used for the computation of diluted earnings per share:

	1997	1996
Weighted average shares used in computation of basic earnings per share	9,234,926	9,194,558
Weighted average shares from assumed conversion of dilutive options	372,994	587,733
Weighted average shares used in computation of diluted earnings per share	9,607,920	9,782,291

Statement of cash flows

Under United States GAAP, cash flows provided by financing and used in investing would decrease by \$1,300, which represents the share consideration paid for the acquisition of 3L Limited, which is a non-cash transaction which would not be reflected in the statement of cash flows.

Acquisition of 3L Limited

Under United States GAAP, amounts paid for in-process research and development acquired through a business combination are expensed at the time of acquisition.

Accounts payable and accrued liabilities

	1997	1996
Accounts payable	\$ 4,277	\$ 4,525
Accrued liabilities	2,418	1,515
Deferred revenue	27	876
	\$ 6,722	\$ 6,916

Income taxes

Under United States GAAP, deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Temporary differences are tax-effected at current rates whereas under Canadian GAAP, temporary differences are tax-effected at historic rates. There was no deferred tax effect of changes in tax rates during 1997.

The tax effect of the temporary differences that give rise to deferred tax assets and deferred tax liabilities are presented below:

	1997	1996
Deferred tax assets		
Tax loss carryforwards	\$ 43	\$ -
Research and development expenses	-	834
Investment tax credits recoverable	327	330
Share issue costs	121	247
Other	37	3
Total gross deferred tax assets	528	1,414
Less: valuation allowance	(339)	(615)
Total deferred tax assets	189	799
Deferred tax liabilities		
Research and development expenses	(943)	-
Tax depreciation in excess of accounting	(847)	(706)
Investment tax credits	(148)	(148)
Total deferred tax liabilities	(1,938)	(854)
Net deferred tax liabilities	\$ (1,749)	\$ (55)

Management is of the opinion that it is more likely than not that the results of future operations will generate sufficient taxable income to realize the deferred tax asset. The Company's ability to realize its deferred tax assets is based on several factors, including a presumption of future profitability, and is subject to some degree of uncertainty.

Same as CDN
DIT number -
not a CAN-AM
difference

Notes to Consolidated Financial Statements

Stock based compensation

The Company adopted the disclosure provisions of Statement of Financial Accounting Standards No. 123 ("FAS 123"), Accounting for Stock-Based Compensation, for United States GAAP purposes, to account for grants under the Company's existing stock based compensation plans. Accordingly, no compensation cost has been recognized for the stock option plan. Had compensation cost for the Company's stock option plan been determined based on the fair value at the grant date for awards under those plans consistent with the measurement provisions of FAS 123, the Company's net earnings and earnings per share under United States GAAP would have been adjusted as follows:

	1997	1996
Net earnings		
as reported	\$ 1,415	\$ 2,150
Net earnings		
pro forma	\$ 119	\$ 1,368
Basic earnings per share		
as reported	\$ 0.15	\$ 0.23
Basic earnings per share		
pro forma	\$ 0.01	\$ 0.15
Diluted earnings per share		
as reported	\$ 0.15	\$ 0.22
Diluted earnings per share		
pro forma	\$ 0.01	\$ 0.14

Pro-forma amounts reflect options granted after 1994 and may not be representative of amounts in future years.

The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option-pricing model with the following assumptions:

	1997	1996
Expected dividend yield	0%	0%
Expected stock price volatility	27%	45%
Risk-free interest rate	7.5%	8%
Expected life of options	4.5 years	4.5 years

The weighted average fair value of the options granted is \$2.89 (1996 - \$6.26) per option.

Recent United States accounting standards

Statement of Financial Accounting Standards FAS 130, "Reporting Comprehensive Income" and FAS 131, "Disclosures about Segments of an Enterprise and Related Information" are required to be implemented by the Company effective for the year ending December 31, 1998. The Company does not expect the effect of these pronouncements to be material to the financial statements.

Glossary

3L Limited - An independent DSP software tools company acquired by Spectrum in 1997. 3L is located in Scotland and specializes in software referred to as Real-Time Operating Systems (RTOS) for DSP-based systems with many DSP processors in one system.

Analog - Signals or waves, formed by light, sound and data in the real world, are analog-based.

ASIC - Application Specific Integrated Circuit, otherwise known as a hardwired or non-programmable chip. Usually designed for only one specific purpose and manufactured in large volumes.

COTS - Commercial-off-the-Shelf, represents a term for a board-level product that is non-custom and is readily available to the general marketplace from various board vendors.

Diagnostic Imaging Equipment - Equipment used for medical diagnostic purposes, such as MRI machines and CAT scan machines.

Digital - Ones and zeros; analog information must be translated into digital information (computer language) before it can be manipulated, calculated or analyzed.

Digital Signal Processing (DSP) - a specialized micro-processor that processes digital signals. The process of collecting real-world or analog signals, turning them into ones and zeros [or the digital realm], manipulating / calculating the data, then turning them back into real-world processing signals such as radio signals, video conferencing, cellular phone audio, etc.

DSP Algorithms - Software code developed for digital signal processors that enables the system to complete useful functions. An example of a useful function would be a modem or wireless base station.

ISO 9001 - International quality certification, recognizing an internationally accepted quality standard. Includes manufacturing, design and development of all Spectrum products.

Loughborough Sound Images (LSI) - A competitive DSP company located in the UK. Most of Spectrum's legacy product line was licensed from LSI. In 1994, Spectrum began to design, build and manufacture its own product line. LSI licensed products are expected to make up less than 5% of Spectrum's revenue in 1998.

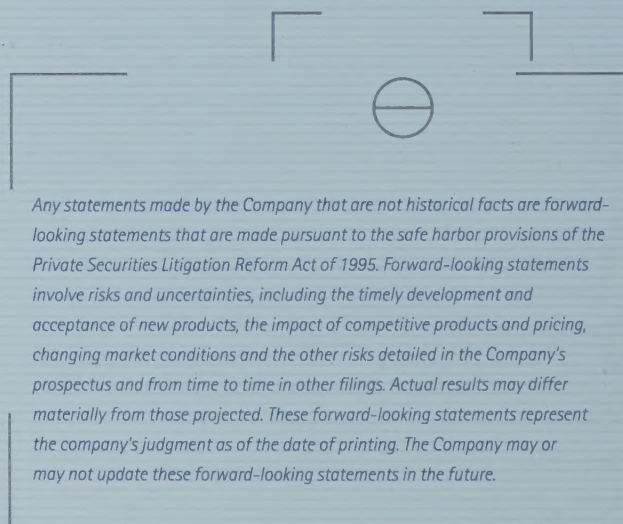
MAC - Military, Aerospace and Commercial: refers to the three major market areas the company focused on in 1997.

Microprocessor - A general-purpose central processing unit (CPU) primarily used for non real-time applications.

OEM - Original Equipment Manufacturer. A company that buys components from various suppliers to build end-user products such as diagnostic imaging equipment.

Real-Time - The ability to absorb data, process it, and output it in a pre-defined amount of time that is so short as to be perceived by the human brain as instantaneous.

Texas Instruments - The world's largest DSP chip manufacturer, based in Dallas, Texas.



Board of Directors

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First Bank Tower
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& Registered Office

Clark Wilson
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Shares Listed

NASDAQ NMS – SSPIF
Toronto Stock Exchange – SSY

Annual General Meeting

The annual general meeting of
shareholders will be at 1:30 pm
Wednesday, June 10th, 1998 at:

The Waterfront Hotel
900 Canada Place Way
Vancouver, BC V6C 3L5



high performance



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